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TAGS: ECON PGOV PREL GG EFIN
SUBJECT: GEORGIA: 2009 BUDGET REVENUE OUTLOOK IMPROVES BUT STILL GRIM

Classified By: AMBASSADOR JOHN F. TEFFT. REASONS: 1.4 (B) AND (D).

¶1. (C) Summary: The Ministry of Finance projects that budget revenues will increase by about GEL 160 million in 2009 even factoring in the PM's recent proposal for an accelerated tax cut. Revenue projections for 2009 reflect only the GEL 700 million in international aid for which an official agreement has been signed. The Ministry of Finance expects that number to grow substantially over the course of 2009 as aid pledged at the October 22 Brussels Donors Conference become available. The GOG remains hopeful that revenues and aid will be sufficient to finance expenditures through the first quarter of 2009 - a scenario that is still very much in doubt. Although revenues are down roughly $270 million because of the August conflict, the budget gap was filled by the use of the GOG's sovereign wealth fund and aided by the recent tranche of $250 million of direct budget support from the USG. Better than expected tax receipts for September and October, coupled with a recent agreement with the Asian Development Bank for $70 million of direct budget support means the overall budget revenue situation moving forward looks better than a month ago. See Septel for a breakdown of the 2009 budget proposal. End Summary.

¶2. (C) Comment: All told, the GOG still faces a difficult first two quarters as revenues generally lag, a condition that will be exacerbated by the war and global economic crisis which has halted previously robust GDP growth. GOG budget calculations are based on a prediction of 4% GDP growth which may be overly optimistic. Most GOG contacts estimate GDP growth for 2009 will be between 2 and 5%. The GOG has wisely not incorporated any promised aid for which agreements have not been completed into budget calculations. If revenue receipts drop precipitiously, which so far has not been the case, foreign aid inflows could potentially fill the gap or at least mitigate against any budgetary crisis. The GOG will be monitoring revenue inflows very carefully as it desperately wants to avoid any scenario which would force budgetary spending cuts in a slowing economy. While GoG initial numbers show an overall increase in revenues, this is likely due to the cashing in of the government's soverign wealth funds that were created earlier in 2008. Unfortunately, while these funds add to the budget for 2009, they are not unencumbered revenue. The government will have to eventually pay out on the floated Eurobonds. End Comment.

Accelerated Tax Cuts To Provide Stimulus

¶3. (C) PM Mgaloblishvili has proposed an accelerated tax cut in the hopes of stimulating consumer spending especially during the first two quarters of 2009 which traditionally show slower growth and revenue streams (septel). The move is hardly surprising given the long-term GOG strategy to lower taxes coupled with a desire to provide a fiscal stimulus in a slowing economy. Pending Parliamentary approval, the income tax rate will fall from 25% to 20% and the dividend tax from 10% to 5%. The tax rate was previously scheduled to decrease annually (1% in 2009) eventually settling at a 15% flat tax on income in 2013. Taxes on dividends were schedule to

follow the same arch with the ultimate elimination of taxes on dividends in 2013. PM Mgaloblishvili has publicly argued the cuts "mean that the income of all employed people will increase, as well as their savings. In addition, a tax cut is a good precondition for creating new jobs." Economic
Qis a good precondition for creating new jobs." Economic analyst Gia Khukhashvili suggested that the tax cut alone will not be enough to drive the short-term economic development of the country, but he welcomed it all the same as a positive overall policy step for long term development.

Budget Projections Harbor Many Unknowns

¶4. (C) Deputy Finance Minister Papuna Petriashvili told us that decreased revenues because of the tax cut have been reflected in the 2009 budget. He stated that the accelerated tax cut had been decided on in October, and planning had proceeded accordingly. The Ministry of Finance calculates the tax cut will cause a shortfall of roughly GEL 250 million compared with leaving tax rates at 2008 levels. Even with the proposed tax cut, the Ministry of Finance believes overall revenue inflows will increase by about GEL 160 million. Petriashvili noted the reoccurring trend that despite past tax cuts, GOG overall income tax revenues have incresed. He expects to see a similar result as more people regularize their tax status and incomes grow in general. This potential revenue increase also has not been accounted for in any of the current budget planning and could provide additional budgetary wiggle room if realized. Inflation is projected at a manageable 7% so the cuts are not expected to cause any overarching inflationary problems. Petriashvili said the cuts were in line with the GOG's general policy goal

of gradually lowering taxes over time and not did not represent any departure from their overall long-term economic plan.

¶5. (C) Petriashvili expects budget inflows to be significantly plused up by foreign assistance. If agreements are reached expeditiously, foreign aid could provide critical budgetary support during the 1st and 2nd quarters of 2009 which are more likely to face a budgetary crunch. He cautioned that for planning purposes, the Ministry of Finance has created a 2009 draft budget which does not contemplate any foreign assistance for which an agreement has not been signed. Petriashvili said budget projections will have to be continually updated depending on the nature of the assistance. The budget implications of the foreign assistance inflows will become clearer in time, but Petriashvili expects the large majority of foreign aid to be spent on infrastructure development and social aid, all of which can be expected to provide a further economic stimulus.
TEFFT